

From: The Savings Bank, Kathy Conary
Subject: Availability of Funds and Collection of Checks

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Proposal: Regulation CC - Availability of
Funds and Collection of Checks
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Comments:

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Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th and C Streets, NW
Washington, DC 20551

Re: Comments to Proposed Amendments to Regulation CC
Docket Number: R-1176

Dear Ms. Johnson:

The Savings Bank is small community bank in Massachusetts with assets of \$400 million. We thank you for the opportunity to comment on the to Proposed Amendments to Regulation CC which would implement the Check Clearing for the 21st Century Act.

We support many of the provisions in the proposal, although we would like to address some items for reconsideration.

Delivery of Notice at Time of Consumer Request for Copy of Check

Section 229.57(b)(2) of the Proposal provides two alternatives for a financial institution to provide the disclosure notice requirements after the consumer requests a copy of the check. They are: (1) at time of request for original or copy of check, or (2) at the time the bank provides substitute check.

The first alternative, delivery at the time the request is made, raises some operational difficulties since a bank may not know it would be providing a copy of a substitute check until after the request has been made by the consumer.

We strongly support the second alternative which provides that a financial

institution which sends a substitute check in lieu of the original check must give disclosure at the time the substitute check is provided rather than the at the time the consumer requests the check.

Substitute Checks

Section 229.2(zz) (definition of substitute check) provides that a reconverting bank may correct an amount encoding error and should correct a MICR-read error from the original check. The Proposal provides that the failure to correct the amount on the MICR field of the substitute check does not affect the status of the substitute check as the legal equivalent to the original check. We agree with this provision.

Section 229.51(c) of the Proposal provides that if a bank transfers and receives consideration for an item that meets all the requirements of a substitute check except for the MICR line requirement in Section 229.2(zz)(2), that item is a substitute check for purposes of the expedited re-credit, indemnity and warranty provision of the regulation. However, Section 229.51(2)(c) provides that a substitute check that does not have the correct routing and transit number would not be substitute check under the Check 21 Act and is not a legal equivalent of the original check, but would be subject to the warranties, indemnities and re-credit rights applicable to substitute checks.

Even if the MICR line on the substitute check does not accurately represent the MICR line on the original check, the substitute check should still qualify as the legal equivalent of the original check. Under this approach, the MICR line of the substitute check could vary from the MICR line of the original check and transit fields, or in any other field. In all cases, provided the reconverting bank places in MICR line on the substitute check in MICR ink, the substitute check retains its legal equivalence to the original check. We believe this approach is necessary to instill confidence in the parties' processing and receiving substitute checks that they are the legal equivalent of the original check. Banks in the check collection process need to know that they can process a substitute check and treat it as the original check. In most cases, a collecting bank will not know that there is an error in the MICR line of a substitute check that the bank receives from a reconverting bank, and the collecting bank will transfer that check to a subsequent collecting bank or to the paying bank.

The final rules should permit a bank repair any portion of a MICR line on a substitute check that it receives in the check collection process but should not be obligated to do so. We believe that any rules under the Check 21 Act for repair of substitute checks should be designed to encourage banks to treat substitute checks in the same manner as original paper checks. A substitute check that is repaired should not lose its status as the legal equivalent to the original check, regardless of type of repair (full or partial) and regardless of the accuracy of repair. Rather, the collecting bank or paying bank that repairs a substitute check in a manner that results in inaccurate MICR line information would breach the encoding warranties under the UCC and Regulation CC.

Model Consumer Educational Document

We believe that the model disclosure for the consumer education document included in the Proposal is too long and detailed. The Check 21 Act requires a bank to provide a "brief notice" regarding the consumer re-credit rights and the legal equivalency of the substitute check. Consumers are not likely to

read long disclosures and may be confused by the intricacy of the proposed model disclosure. We recommend that the model disclosure simply define and describe a substitute check, explain that consumers may have certain rights under the federal and state check laws, and they should contact their financial institution.

The proposal includes a number of other model disclosures that financial institutions may use to satisfy various notice and disclosures requirements under the Act. These notices are helpful to the financial services industry, and will provide useful consistency to the notices. In addition, we recommend that the final rule endorse the use of notices other than the model disclosures and state that in the view of the Federal Reserve, such notices would constitute compliance with the Act.

Re-credit of Interest on Invalid Claims

The Board's proposal under Section 229(c)(4) requests comments on whether the interest should be reversed if re-credit is reversed in the event of an invalid claim. This is particularly important since Check 21 does not explicitly address the reversal of interest when reversing a credit. We do not believe that consumers should benefit from an invalid claim.

In addition, forty days represents an adequate period for the customer to submit a claim for a transaction that he/she believes is in error. However, Reg. E Error Resolution (Section 169f (908)) allows sixty days to notify. I would recommend that forty-day period be amended to sixty days to parallel Reg. E. and avoid any confusion to the consumer.

Indorsements Standards

The Board request comments on whether it should provide returning banks with the flexibility to indorse on the front of the check and include additional information with their indorsements. We anticipate that there will be problems with this approach because it may make it harder to detect forgery and interfere with fraud prevention tools.

Replacement Checks

We believe that there is at least one additional area of the existing rule and commentary, which should be clarified. Specifically, there may be a possibility for dishonest individuals to perpetrate fraud through the use of "replacement checks". In that case, it is our belief that since the Financial Institution of the first deposit is compelled to know its customer (USA PATRITOT Act) and should be liable.

Thank you for the opportunity to submit our comments on this proposal.

Sincerely,

Kathy Conary
Compliance Officer

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